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I Just Realized We Hired a Debarred Subcontractor, Now What?

A Case Study in NonProcurement Suspension and Debarment

To: ABA Public Contract Law Section, Construction Division

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Date: June 28, 2012

This Case Study relates to Federal Highway Administration (FHWA) and Federal Transit Administration (FTA) guidelines concerning debarred subcontractors, an area where a substantial amount of federally supported construction occurs. Below we introduce the Common Rule[1], from which the applicable regulations derive, and we then answer likely questions.

The Common Rule provides the suspension and debarment regulations governing all federal non-procurement transactions, *e.g.* Department of Transportation (DoT) grants, and any lower tier non-procurement transactions, *i.e.* sub-grants or lower tier procurement transactions. Large construction companies are often in the position of a first tier contractor or lower tier subcontractor in a procurement transaction funded by federal grant funds and that is the setting for this case study. The regulatory analysis begins with the Common Rule, found at 2 C.F.R. § 180, then moves to any department-level regulations, in this case, DoT, 2 C.F.R. § 1200, and finally ends with any agency-specific rules, here FHWA and FTA guidance. Agencies may take different approaches to the same issues, so one must always consult applicable and current agency guidelines.

1. Has the FHWA established an affirmative obligation to check the EPLS system, and if not, how can a contractor satisfy its responsibility not to contract with suspended or debarred subcontractors?

Two common sense ways contractors may decide to manage the risks of subcontracting with suspended or debarred contractors are to get a certification from every subcontractor or to incorporate the Prime Contract's prohibition on contracting with suspended or debarred entities by reference. However, according to FHWA regulations,

[1] The Common Rule is an anachronism and a misnomer as every agency now implements the requirements of 2 C.F.R. § 180 through agency-specific regulations.

contractors must do something different – incorporate a specific FHWA clause in covered transactions.

The Common Rule provides that a party to any covered transaction (generically a "participant"[2]), at any tier, may satisfy its due diligence obligation regarding participants at the next lower tier by any of three methods: (a) checking the EPLS; or (b) collecting a certification; or (c) adding a clause or condition to the covered transaction. 2 C.F.R. § 180.300. Thus, a participant may satisfy its due diligence obligation by any method it chooses, unless the agency includes more specific requirements. *Id*. at § 180.330. And participants must require lower tier participants to flow the requirement down to any "covered transaction," which would be any related subordinate transaction with any participant that is expected to exceed $25,000.

At the next level of analysis applicable in this case study, the DoT regulations specify that contractors must incorporate a term or condition in lower tier agreements that advises the subcontractor of its obligation to comply with the Common Rule. 2 C.F.R. § 1200.332.

Finally, at the third level of analysis, FHWA provides even more specific direction that first tier participants must include the clause titled "Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion-Lower Tier Covered Transactions" *without modification* in all lower tier covered transactions and solicitations for lower tier covered transactions exceeding $25,000. FHWA 1273 § X.1.g.; *see also id*. at X.2.f (requiring lower tier participants to incorporate the same clause in their lower tier covered transactions).[3] The same FHWA guidelines, state explicitly that a participant "may, but is not required to" consult EPLS. FHWA 1273 § X.1.h. They go on to add that a participant's "knowledge and information…is not required to exceed that which is normally possessed by a prudent person in the ordinary course of business dealings." FHWA 1273 § X.1.i. We have found no contradictory guidance in the other FHWA documents we have reviewed, including FHWA Order 2000.2a: FHWA Nonprocurement Suspension and

[2] Participants may include grantees, also known as recipients, as well as sub-grantees, also known as sub-recipients, plus contractors, subcontractors, suppliers, vendors, consultants, and any other entity that is expected to participate in a related transaction over $25,000 in value.

[3] This guidance document, FHWA 1273 – Required Contract Provisions Federal-Aid Construction Contracts from 1994 is still in effect according to FHWA's website. A revised, but apparently not yet accepted, October 18, 2011 revision to FHWA 1273 is on FHWA's website, but the relevant provisions have not changed materially.

Debarment Process (Federal-Aid Program) and FHWA Policy Memorandum HAAM-10: Revised Process for Suspension and Debarment Actions.

Inserting the required clause in all lower tier transactions and solicitations, would appear to satisfy both a contractor's due diligence and flow down requirements. And when performing on FHWA projects, we are aware of no additional requirement to consult EPLS or to incorporate the prime contract by reference.

2. If a contractor unknowingly used a debarred subcontractor on FHWA work, but has ceased using them upon discovery, is the contractor obliged to notify the owner?

Under the Common Rule, a participant at the primary tier[4] of a covered transaction is required to disclose information concerning it or its principals'[5] eligibility, certain criminal or civil convictions or charges and recent terminations for cause on public work. 2 C.F.R. § 180.335. If a participant subsequently learns of information it was required to disclose under § 180.335, it must immediately notify the agency in writing. *Id*. at § 180.350. Since a participant's disclosure obligations under § 180.355 relate to itself and its

[4] It would seem to be rare for a company to be a "participant at the primary tier" except when contracting directly with the federal government. 2 C.F.R. § 180.335. However, the definitions of "participant", "covered transaction" and "person" in the Common Rule are very broad and cross-referencing them is a circular exercise. As a result, for purposes of this case study, we have assumed that the contractor could be a participant at the primary tier if it is a prime contractor with a recipient or sub-recipient and its contract states that it is subject to the requirements of the Common Rule. *See* 2 C.F.R. § 180.225. As will be shown, even if the company were considered to be a participant at the primary tier, the result would not change.

[5] Principal means—

(a) An officer, director, owner, partner, principal investigator, or other person *within a participant* with management or supervisory responsibilities related to a covered transaction; or

(b) A consultant or other person, whether or not employed by the participant or paid with Federal funds, who—

(1) Is in a position to handle Federal funds;

(2) Is in a position to influence or control the use of those funds; or,

(3) Occupies a technical or professional position capable of substantially influencing the development or outcome of an activity required to perform the covered transaction.

principals, but not lower tier entities, there is no affirmative obligation under § 180.350 for a participant to disclose information about the debarred status of its subcontractors. Moreover, the Common Rule says that a participant may decide to continue working with an entity that has become debarred during performance, and does not require the participant to provide any notice of its decision. 2 C.F.R. § 180.310. The DoT does not provide any further guidance on this point, and states that matters not dealt with in DoT regulations are governed by the Common Rule. 2 C.F.R. § 1200.30.

FHWA 1273 specifically addresses the situation where either the primary or a lower tier participant determines that its own certification is erroneous. With respect to the primary participant, it must provide immediate written notice to the contracting agency "if any time[sic] [it] learns that its certification was erroneous when submitted or has become erroneous by reason of changed circumstances." FHWA 1273 § X.1.d. The primary participant's certification relates only to its own responsibility and that of its principals. *See id*. at § X.2. A participant at the next lower tier must provide notice to the primary participant, "if at any time [it] learns that its certification was erroneous by reason of changed circumstances." *Id*. at § X.3.c. But there is nothing that specifically requires the primary participant to pass on that notification to the contracting agency.

Thus, the FHWA guidance, like the Common Rule and DoT regulations, does not create an affirmative obligation to report up a subsequent discovery that a lower tier participant was debarred before or after performance began.

3. Has the FTA established an affirmative obligation to check the EPLS system, and if so, must a contractor notify the owner that it unknowingly used a debarred subcontractor? What about lower tier subcontractors' responsibility to report up?

We found no obligation under FTA's rules for a contractor or subcontractor to check EPLS. According to an FTA ethics page on its website, the FTA imposes an affirmative obligation to check EPLS on grantees, but the website is inconsistent with published FTA guidance when it comes to the obligations of contractors and subcontractors. In fact, after reviewing key FTA guidance documents, we did not find any basis for the assertion that any participant, including grantees, would have an obligation to check EPLS. FTA's Third Party Contracting Guidance says only that the "FTA strongly recommends that

the recipient check" EPLS,[6] and its *Best Practices Procurement Manual* notes that recipients "may but are not required to" consult EPLS.[7]

As explained above, the Common Rule and DoT regulations do not, themselves establish an affirmative obligation that would compel a prime contractor (or a higher tier subcontractor) to notify the agency when it learns that one of its subcontractors was, in fact, debarred. Thus, the only federal source of such an obligation would be any more restrictive FTA guidance. The FTA's ethics website says, "In the event that a ***grantee*** becomes aware, after the award of a contract, that an excluded party is participating in a covered transaction, it must promptly inform FTA in writing of this information." Emphasis added. The references provided for that guidance are the Common Rule and DoT regulations, which do not support that statement, as explained above. Further, the use of the term grantee, does not logically reach contractors.

It is worth noting that the Federal Fiscal Year 2011 Annual List of Certifications and Assurances for Federal Transit Administration Grants and Cooperative Agreements, published in the Federal Register has broadened the definition of principals for FTA's suspension debarment certification purposes to include first tier "subrecipients." *See* Fed. Reg. Vol. 75, No. 211, Tuesday, November 2, 2010, 67437 (attached). As a result of that same change to the Master Agreement, the certification now includes a representation that the "Applicant (Primary Participant)" and its principals (including first tier subrecipients) "assure that each lower tier participant involved in the Project is not presently debarred, suspended, proposed for debarment, [etc.]" Further, the Applicant must now certify that "if later, it or its principals, including any of its first tier subrecipients, become aware of any information contradicting" its earlier certifications, "it will promptly provide any necessary information to FTA."

We do not believe these provisions change the analysis as to the obligations of a contractor or subcontractor on an FTA project. Although we have not found a definition in FTA guidance, we believe the term "Applicant (Primary Participant)" refers to the direct recipient of FTA grant funds, *i.e.* a grantee, which is rarely, if ever, a construction company. Further, FTA's definition of subrecipient expressly excludes contractors and subcontractors.[8]

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[6] FTA Circular 4220.1 F, Third Party Contracting Guidance, Rev. 3, Feb. 15, 2011.

[7] *Best Practices Procurement Manual* § 4.3.3.2.1. The FTA Master Agreement also does not mandate use of EPLS.

[8] Subrecipient - Any entity that receives Federal assistance awarded by an FTA recipient rather than from FTA directly. The term "subrecipient" also includes the term "subgrantee," but does not include "third party contractor" or "third party subcontractor." FTA *Best Practices Procurement Manual* at § 1.3.1.

Logically, in order to have a subrecipient, an Applicant must be a "recipient" which FTA defines as "any entity that receives Federal assistance directly from FTA to accomplish the project." *Id*.

Applying the new requirement from the FTA Master agreement to the case study it does not appear to us that contractors that erroneously used a suspended or debarred subcontractor or supplier have any obligation to "provide any necessary information to FTA." That is the responsibility of the Applicant and its first tier subrecipients. Nonetheless, it would be a fair reading of the new FTA certification requirement, that at least for ongoing work, an Applicant should report known erroneous certifications by it or its first tier subrecipients. Since Applicants and their first tier subrecipients are ostensibly assuring that each lower tier participant involved in the Project is not presently debarred, suspended, or proposed for debarment, they would be obligated to notify FTA of any subcontractor's debarment. But contractors and subcontractors at any tier have no affirmative obligation to report up.

This review relates only to the applicable DoT and FHWA or FTA regulatory requirements. We note that the Applicant/Recipient/Grantee may have its own requirements, and/or contract language that imposes additional obligations beyond those set out in the Common Rule and the subordinate department and agency guidance. As always, there may be other reasons contractors choose to communicate certain information, but for the reasons above, and barring additional restrictions in your contract or rules promulgated by the contracting entity, we are not aware of any statutory or regulatory obligation for contractors that inadvertently hire a suspended or debarred entity to make any government disclosure.

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